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In the Supreme Court of the United States

OCTOBER TERM, 1988

PAUL S. DAVIS, APPELLANT

v.

STATE OF MICHIGAN

ON APPEAL FROM THE MICHIGAN COURT OF APPEALS

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether the doctrine of intergovernmental tax immunity, as embodied in 4 U.S.C. 111, prevents the State of Michigan from taxing the retirement benefits of former federal employees while exempting from taxation retirement benefits paid by the State and its political subdivisions.

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INTEREST OF THE UNITED STATES

The State of Michigan exempts from taxation all pensions paid to retired employees of the State of Michigan and its political subdivisions. Pensions received from other sources, including the federal government, are taxed when they exceed certain limits. This disparate treatment afforded to state and federal pensions harms the United States in two respects. First, the United States is put at a competitive disadvantage in hiring qualified employees. In order to provide its retirees with the same net after-tax benefit as state retirees—and, hence, in order to attract the same quality of employee—the United States must pay out more money in pension benefits than the State.

Second, through the use of its discriminatory tax scheme, the State is indirectly forcing the United States to subsidize the pensions of state retirees through lower federal tax revenues. If the State taxed its own pension

benefits, and increased pensions to offset that tax, the increase in pensions would in turn increase the federal tax liability of state retirees. Thus, in order to confer the same monetary advantage upon state retirees, the State would have to pay out more in additional benefits than it foregoes in lost tax receipts. At bottom, therefore, the special tax exemption for state retirement benefits amounts to an effort to increase the net after-tax benefit received by retired state employees at the expense of federal taxpayers.

Under the nondiscrimination principle, which is part of the doctrine of intergovernmental tax immunity, the State must make a choice. It can impose a tax on both state and federal pensions (thereby increasing the costs of both the federal and state governments) or it can make both federal and state pensions nontaxable (thereby decreasing the revenues of both federal and state governments). But it cannot impose a tax on federal pensions that does not apply to state pensions; such a tax increases the costs and decreases the revenues of the federal government while simultaneously decreasing the costs and increasing the revenues of the state government.

STATEMENT

1. The State of Michigan exempts from taxation all pensions and retirement benefits paid to retired employees of the State of Michigan and its political subdivisions. Pensions and retirement benefits received from other sources, including federal retirement benefits, are deductible only up to $7,500 for a single return and $10,000 for a joint return. See Mich. Comp. Laws Ann. § 206.30 (1)(f) (West 1986 & Supp. 1988); Mich. Stat. Ann. § 7.557 (130) (Callaghan 1984).[1]

Appellant is a retired federal employee living in Michigan. After paying state income tax on his federal pension for a number of years, appellant filed a complaint in the Michigan Court of Claims seeking a refund. He alleged that the Michigan Income Tax Act discriminated in favor of state retirement benefits and against federal retirement benefits in violation of 4 U.S.C. 111.[2]

2. On cross-motions for summary judgment, the Michigan Court of Claims concluded in an oral opinion

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[1] Section 206.30(1)(f) provides in relevant part:

(1) "Taxable income" in the case of a person other than a corporation, estate, or trust means adjusted gross income as defined in the internal revenue code subject to the following adjustments:

* * * * *

(f) Deduct to the extent included in adjusted gross income:

(i) Retirement or pension benefits received from a public retirement system of or created by an act of this state or a political subdivision of this state.

(ii) Any retirement or pension benefits received from a public retirement system of or created by another state or any of its political subdivisions if the income tax laws of the other state permit a similar deduction or exemption or a reciprocal deduction or exemption of a retirement or pension benefit received from a public retirement system of or created by this state or any of the political subdivisions of this state.

(iii) Social security benefits as defined in section 86 of the internal revenue code.

(iv) Retirement or pension benefits from any other retirement or pension system as follows:

(A) For a single return, the sum of not more than $7,500.00.

(B) For a joint return, the sum of not more than $10,000.00.

[2] Section 111 provides in pertinent part:

The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States * * * by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

that the Michigan Income Tax Act did not violate Section 111 because a retired federal civil servant is not currently an "officer or employee of the United States" within the meaning of that provision (J.S. App. A10-A11). The Michigan Court of Appeals affirmed (*id.* at A1-A8). The court agreed with the Court of Claims that someone who is not currently working for hire is not an "employee." Section 111, the court therefore concluded (J.S. App. A6), "has no application to [appellant], since [appellant] cannot be considered an employee within the meaning of that act."

The court of appeals further concluded that the Michigan Income Tax Act did not violate equal protection because the favorable treatment afforded to state retirees "bear[s] a rational relationship to a legitimate state end" (J.S. App. A6-A7). "In our opinion," the court stated (*id.* at A7), "the attracting and retaining of qualified employees is a legitimate state objective which is rationally achieved by a retirement plan offering economic inducements" such as "tax exempt status for their retirement benefits." The court justified the discrimination against similarly-situated federal employees by noting (*ibid.*) that "[t]he State of Michigan, as an employer, owes a special responsibility to its employees, which it does not owe to federal employees." Appellant's application for leave to appeal to the Supreme Court of the State of Michigan was denied (*id.* at A9).

SUMMARY OF ARGUMENT

Contrary to the Michigan Court of Appeals, Section 111 applies not simply to the taxation of current employees of the United States, but to "the taxation of pay or compensation for personal service as an officer or employee of the United States." Appellant's pension is clearly compen-

sation, albeit deferred compensation, "for" his years of "service as an * * * employee of the United States." Appellant's pension therefore falls within the scope of Section 111.

Section 111 itself merely restates, in the context of state taxation of the compensation of federal employees, the general constitutional rule requiring nondiscrimination in state taxation of those dealing with the federal government. Under the nondiscrimination principle, a State may not treat its own former employees more favorably for income tax purposes than former federal employees, unless there are significant differences that justify treating these two classes of former employees unequally. Neither the lower courts nor appellees have advanced any distinction between state and federal retirees that would qualify under this standard.

Appellant's pension is subject to taxation for the simple reason that it is paid by the federal government rather than by the State or one of its subdivisions. The tax imposed by Michigan on that pension thus discriminates against federal retirees and in favor of state retirees based solely on "the source of the pay or compensation" (4 U.S.C. 111). It follows that the Michigan tax is invalid.

ARGUMENT

THE DOCTRINE OF INTERGOVERNMENTAL TAX IMMUNITY, AS EMBODIED IN 4 U.S.C. 111, PREVENTS THE STATE OF MICHIGAN FROM TAXING THE RETIREMENT BENEFITS OF FORMER FEDERAL EMPLOYEES WHILE EXEMPTING FROM TAXATION RETIREMENT BENEFITS PAID BY THE STATE AND ITS POLITICAL SUBDIVISIONS

Section 111, by its plain terms, forbids discriminatory taxation of a retired federal employee who, through his pension, is still receiving "compensation for personal serv-

ice as an officer or employee of the United States." If construed the same way as the nondiscrimination principle derived from the doctrine of intergovernmental tax immunity, Section 111 precludes a State from treating its own former employees more favorably for income tax purposes than former federal employees, absent a showing of significant differences between the two classes. Neither the courts below nor appellees have identified any such differences. The judgment of the Michigan Court of Appeals should therefore be reversed.

1. The Michigan Court of Appeals erred in concluding that appellant does not fall within the protection of Section 111. The court stated that as used in other contexts the term "employee" embraces only those who currently work for "hire" and that "a retired federal civil service employee is not to be considered an employee for civil service purposes." J.S. App. A4-A5. That is true (see, *e.g.*, *Chemical Workers* v. *Pittsburgh Glass*, 404 U.S. 157 (1971); *Lancellotti* v. *Office of Personnel Management*, 704 F.2d 91, 95 (3d Cir. 1983)); but it is also irrelevant. By its terms, Section 111 applies not just to the taxation of current employees of the United States, but to "the taxation of pay or compensation for personal service as an officer or employee of the United States." Appellant's pension is clearly compensation, albeit deferred compensation, "for" his years of "service as an * * * employee of the United States." See, *e.g.*, *Zucker* v. *United States*, 758 F.2d 637, 639 (Fed. Cir.), cert. denied, 474 U.S. 842 (1985); *Kizas* v. *Webster*, 707 F.2d 524, 535-536 (D.C. Cir. 1983), cert. denied, 464 U.S. 1042 (1984); *Clark* v. *United States*, 691 F.2d 837, 842 (7th Cir. 1982). Appellant's pension therefore falls within the scope of Section 111.[3] It

[3] Prior to enactment of the Public Salary Tax Act of 1939, ch. 59, 53 Stat. 574, from which Section 111 derives, "pensions or retiring

follows that if the tax imposed by Michigan on that pension discriminates against federal retirees and in favor of state retirees based solely on "the source of the pay or compensation" (4 U.S.C. 111), then the Michigan tax is invalid.

2. Section 111 merely restates, in the context of state taxation of the compensation of federal employees, the general constitutional rule requiring nondiscrimination in state taxation of those dealing with the federal government. That rule, which is part of the constitutional doctrine of intergovernmental tax immunity, arises from the Supremacy Clause (Art. VI, Cl. 2). See *South Carolina* v. *Baker*, No. 94, Orig. (Apr. 20, 1988), slip op. 12, n.10. Under the doctrine of intergovernmental tax immunity, "States may not impose taxes directly on the Federal Government, nor may they impose taxes the legal incidence of which falls on the Federal Government." *United States* v. *County of Fresno*, 429 U.S. 452, 459 (1977). For many years this doctrine was interpreted broadly to prohibit state taxation of the salaries of officers and employees of the United States (*Dobbins* v. *Commissioners of Erie County*, 41 U.S. (16 Pet.) 435 (1842)), as well as federal taxation of the salaries of state officials. *Collector* v. *Day*, 78 U.S. (11 Wall.) 113 (1870).[4] In *Helvering* v.

allowances paid by the United States or private persons" were specifically designated as part of the recipient's "[c]ompensation for personal services" under applicable federal tax laws. See, *e.g.*, Treas. Reg. 45, art. 32 (1919); Treas. Reg. 62, art. 32 (1922); Treas. Reg. 74, art. 52 (1929); Treas. Reg. 86, art. 22(a)-2 (1935); Treas. Reg. 101, art. 22(a)-2 (1939). Similarly, state pensions, as "compensation for past services rendered," were specifically excluded from federal taxable income under the doctrine of intergovernmental tax immunity (I.T. 1607, II-1 Cum. Bull. 71 (1923); I.T. 2669, XII-1 Cum. Bull. 68 (1933)), as was other compensation paid by a State or its political subdivisions to its officers and employees (Treas. Reg. 62, art. 88 (1922)).

[4] While federal immunity from state taxation derives from the Supremacy Clause, state immunity from federal taxation is

Gerhardt, 304 U.S. 405 (1938), however, this Court implicitly overruled *Day* by permitting the imposition of a federal income tax on employees of the New York Port Authority. One year later, in *Graves* v. *New York ex rel. O'Keefe,* 306 U.S. 466, 480 (1939), the Court expressly overruled *Dobbins,* declaring that "[t]he theory * * * that a tax on income is legally or economically a tax on its source, is no longer tenable." Since *Graves,* "[s]ubsequent cases have consistently reaffirmed the principle that a nondiscriminatory tax collected from private parties contracting with another government is constitutional" (*South Carolina* v. *Baker,* slip op. 15).

Congressional consideration and enactment of the predecessor of Section 111 responded to, and occurred during, the period of judicial abrogation of the *Day-Dobbins* doctrine. Following the Court's decision in *Gerhardt,* Congress believed there was no longer any constitutional impediment to federal taxation of the income of state employees. In view of this development, Congress concluded that, in fairness, federal officers and employees should no longer remain immune from nondiscriminatory state taxation. Section 4 of the Public Salary Tax Act of 1939 (1939 Tax Act), ch. 59, 53 Stat. 575, the predecessor of Section 111, was designed to waive federal immunity to permit such taxation. See H.R. Rep. 26, 76th Cong., 1st Sess. (1939); S. Rep. 112, 76th Cong., 1st Sess. (1939).

grounded in the Tenth Amendment and in principles of federalism derived generally from the Constitution. *South Carolina* v. *Baker,* slip op. 4 n.4. Despite the different sources of the two doctrines, "[c]ases concerning the tax immunity of income derived from state contracts freely cited principles established in federal tax immunity cases, and vice versa" (*id.* at 11). The two docrines are not, however, coterminous. See n.9, *infra.*

Shortly before the 1939 Tax Act was approved by Congress, however, this Court decided *Graves.* Accordingly, the government's "consent[ ] to the taxation of pay or compensation for personal service as an officer or employee of the United States" in Section 111 was, in effect, merely a codification of the intervening decision overruling *Dobbins.* Nonetheless, in conditioning state taxation of federal employees' compensation on the State's "not discriminat[ing] against the officer or employee because of the source of the pay or compensation," Congress anticipated and also codified "[t]he nondiscrimination principle at the heart of modern intergovernmental tax immunity caselaw." *South Carolina* v. *Baker,* slip op. 19 n.14.[5]

3. This Court's decisions construing the nondiscrimination principle in the context of intergovernmental tax immunities indicate that the Michigan Income Tax Act impermissibly "discriminates" against federal retirees within the meaning of 4 U.S.C. 111. Under the nondiscrimination principle, a tax is invalid, even if it is not imposed directly on the United States, " 'if it operates so as to discriminate against the Government or those with whom it deals.' " *Moses Lake Homes, Inc.* v. *Grant County,* 365 U.S. 744, 751 (1961) (quoting *United States* v. *City of*

[5] Congress may by legislation expand federal tax immunity beyond the confines of the constitutional doctrine. See *Baker,* slip op. 12, n.10 ("The Federal Government * * * possesses the power to enact statutes immunizing those with whom it deals from state taxation even if intergovernmental tax immunity doctrine would not otherwise confer an immunity."). Plainly, Section 111 was not designed to extend federal tax immunity. Nor, on the other hand, is there anything in the language or history of Section 111 to suggest that Congress intended further to limit federal tax immunity by drawing a new distinction between working federal employees and federal retirees when it authorized nondiscriminatory taxation. See n.3 *supra.*

Detroit, 355 U.S. 466, 473 (1958)). See *South Carolina* v. *Baker,* slip op. 16-17; *Phillips Chemical Co.* v. *Dumas Independent School Dist.,* 361 U.S. 376, 387 (1960). Clearly, the burden of the tax in question here falls on those with whom the United States deals. Appellant's pension is subject to taxation solely because it is paid by the federal government rather than by the State or one of its subdivisions. There can, therefore, be little doubt that the Michigan Income Tax Act operates in a discriminatory fashion in imposing a tax upon the retirement benefits of a former federal employee but not imposing it in similar circumstances upon the retirement benefits of former state employees. The principle of nondiscrimination precludes a State from imposing a tax on federal retirees if "it treats someone else better than it treats them." *Washington* v. *United States,* 460 U.S. 536, 545 (1983).

a. Appellees stress (Mot. to Dis. or Aff. 4) that federal retirees have not been singled out for a tax imposed on them alone. Rather, all pensions that are not paid by the State or one of its political subdivisions are treated alike. This Court's decisions, however, have rejected the notion that a State that treats those who deal with itself more favorably than those who deal with the federal government may avoid the charge of discriminatory taxation simply by treating those who deal with the federal government the same as those who deal with private entities.

In *Memphis Bank & Trust Co.* v. *Garner,* 459 U.S. 392 (1983), Tennessee imposed a tax on the net earnings of banks doing business within the State and defined net earnings to include income from obligations of the United States and its instrumentalities but to exclude interest earned on the obligations of Tennessee and its political subdivisions. Although Tennessee treated income from obligations of the United States the same as income from private obligations, the tax was nonetheless declared in-

valid. "It is clear," the Court noted (*id.* at 398-399 (footnote omitted)), "that under the principles established in our previous cases, the Tennessee bank tax cannot be characterized as nondiscriminatory * * *. Tennessee discriminates in favor of securities issued by Tennessee and its political subdivisions and against federal obligations. The State does so by including in the tax base income from federal obligations while excluding income from otherwise comparable state and local obligations. We conclude, therefore, that the Tennessee bank tax impermissibly discriminates against the Federal Government and those with whom it deals." [6]

Similarly, in *Phillips Chemical Co.* v. *Dumas Independent School Dist., supra,* the State of Texas imposed a lesser tax burden on lessees of state property than it imposed on lessees of federal property. The Court held that the discriminatory tax was invalid despite the fact that "there appears to be no discrimination between the [federal] Government's lessees and lessees of private property" (361 U.S. at 381). The crucial point, the Court noted (*id.* at 382), was that the federal lessee "would not be taxed at all if its lessor were the State or one of its political subdivisions instead of the Federal Government. The discrim-

[6] The Michigan court of appeals (J.S. App. A7-A8) sought to distinguish *Memphis Bank* on the grounds that Tennessee's tax was rendered invalid by a specific federal statute, 31 U.S.C. (1976 ed.) 742, which prohibits all but nondiscriminatory franchise or non-property taxes on federal obligations. See also Mot. to Dis. or Aff. 14-18. Section 111, however, has no less force than Section 742 in forbidding discriminatory taxation. Furthermore, in analyzing Section 742, the Court stated that it viewed that statute "as principally a restatement of the constitutional rule" (459 U.S. at 397) and proceeded to scrutinize the Tennessee tax under the general doctrine of intergovernmental tax immunity (*id.* at 397-398), a doctrine that is equally applicable here. *Memphis Bank* is therefore directly on point.

ination against the United States and its lessee seems apparent." "[I]t does not seem too much," the Court concluded (*id.* at 385), "to require that the State treat those who deal with the Government as well as it treats those with whom it deals itself." [7]

The principles governing *Memphis Bank* and *Phillips Chemical Co.* apply with equal force here. The State of Michigan is discriminating in favor of pensions granted by the State and its political subdivisions and against federal pensions. "The State does so by including in the tax base income from federal [pensions] while excluding income from otherwise comparable state and local [pensions]" (*Memphis Bank,* 459 U.S. at 398 (footnote omitted)). Federal pensioners "would not be taxed at all if [their former employer] were the State or one of its political subdivisions instead of the Federal Government. The discrimination against the United States and its [retirees] seems apparent." *Phillips Chemical Co.,* 361 U.S. at 382. It follows that the Michigan tax "impermissibly discriminates against the Federal Government and those with whom it deals" (*Memphis Bank,* 459 U.S. at 399).

[7] Most recently, in *United States* v. *City of Manassas, Va.*, 830 F.2d 530, 534 (4th Cir. 1987), aff'd, No. 87-1117 (Apr. 25, 1988), the Court affirmed a judgment striking down a Virginia tax statute which provided that a company that leased or borrowed personal property from a governmental body was liable for local taxation as if it were the owner of the property. The statute expressly exempted from its provisions property owned by the Virginia Port Authority or by certain local transportation districts. Under the statute, therefore, "all users of property [were] taxed alike, with the exception of those who use[d] the property of the Virginia Port Authority and local transportation districts, both of which are subdivisions of the government of the Commonwealth" (830 F.2d at 533). The court of appeals held the statute unconstitutional, noting that "the discrimination against the federal government in favor of subdivisions of the state government is obvious" (*ibid.*). This Court affirmed summarily.

b. The Michigan Court of Appeals, without denying that the Michigan Income Tax Act discriminates against former federal employees, sought to justify that discrimination under traditional equal protection principles on the ground that the statutory classification "bear[s] a rational relationship to [the] legitimate state end * * * [of] attracting and retaining * * * qualified employees" (J.S. App. A6-A7). But this Court has already made it clear that ordinary equal protection principles "are not necessarily controlling where problems of intergovernmental tax immunity are involved" (*Phillips Chemical Co.,* 361 U.S. at 385). General policy considerations are not sufficient to justify discriminatory taxation against those who deal with the federal government. "The imposition of a heavier tax burden on [those who deal with the federal government] than is imposed on [those who deal with the State government] must be justified by significant differences between the two classes" (*id.* at 383). The court of appeals made no attempt to justify the differential treatment of state and federal retirees under this exacting standard.

The fact that the discrimination at issue here gives the State a competitive edge does not distinguish it from any special tax benefit given to those who deal with the State rather than the federal government. In *Phillips Chemical Co.,* 361 U.S. at 384, the Court expressly rejected a similar justification proffered by the State that favorable tax treatment for its lessees would "facilitate the leasing of its own land." See also *United States* v. *City of Manassas, Va.,* 830 F.2d at 534 (the only "justification" that would support a statute discriminating against those who deal with the United States is "a showing that the two classes of users, from federal and state sources, are not similarly situated, so that in essence there is no discrimination").

Nor can the exemption of state pension benefits from state taxation be justified on the ground that the State

could accomplish the same result by increasing the amount of benefits paid to retirees. If the State increased pension benefits, this in turn would increase the federal tax liability of state retirees. Thus, in order to confer the same monetary advantage upon state retirees, the State would have to pay out more in additional benefits than it foregoes in lost tax receipts. At bottom, therefore, the special tax exemption for state retirement benefits amounts to an effort to increase the net after-tax benefit received by retired state employees at the expense of federal taxpayers.[8] In *Phillips Chemical Co.*, the Court rejected the contention that differential treatment of lessees of state property could be justified because "the State can collect in rent what it loses in taxes from its own lessees" (361 U.S. at 384); the same argument with respect to state pension benefits and taxes should be rejected here as well.

Federal and state retirees appear to be identically situated for purposes of the tax in question here. So too do the federal and state governments in their capacities as employers. At any rate, neither appellees nor the Michigan Court of Appeals has identified any differences that would justify the disparity in treatment between state and federal pensions. "It follows that [the state tax law,] as applied in this case, discriminates unconstitutionally against the United States and its [retirees]." *Phillips Chemical Co.*, 361 U.S. at 387.

4. The policy considerations underlying the doctrine of intergovernmental tax immunity require that the non-

[8] The differential impact in terms of federal taxation is reduced to some extent by the fact that an increase in pension benefits would yield not only higher federal taxes but also higher state taxes, which are generally deductible from income for purposes of determining federal tax liability. But because state income tax rates are invariably lower than federal income tax rates, the higher deduction would never completely offset the additional federal tax liability.

discrimination principle be interpreted so that whatever tax burden is imposed by a State on those who deal with the United States is imposed equally on those who deal with that State. This parity is necessary because the United States has no representation in the individual States, and one State must not be permitted to pursue its own parochial interests at the expense of the other 49 States. "[W]hen a state taxes the operations of the government of the United States, it acts upon institutions created, not by their own constituents, but by people over whom they claim no control. It acts upon the measures of a government created by others as well as themselves, for the benefits of others in common with themselves." *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316, 435 (1819). Such taxation is subject to abuse because "the people outside the state have no representatives who participate in the legislation; and in a real sense, as to them, the taxation is without representation." *Helvering* v. *Gerhardt*, 304 U.S. at 412.[9]

[9] The same concerns are not present when the federal government levies taxes on those who deal with the States and their instrumentalities. "[I]n laying a federal tax on state instrumentalities the people of the states, acting through their representatives, are laying a tax on their own institutions and consequently are subject to political restraints which can be counted on to prevent abuse. * * * The exercise of the national taxing power is thus subject to a safeguard which does not operate when a state undertakes to tax a national instrumentality." *Helvering* v. *Gerhardt*, 304 U.S. at 412. Accordingly, "[m]any of this Court's opinions have suggested that the Constitution should be interpreted to confer a greater tax immunity on the Federal Government than on States because all the people of the States are represented in the Federal Government whereas all the people of the Federal Government are not represented in individual States." *South Carolina* v. *Baker*, slip op. 12 n.10. It is unnecessary to consider in this case whether the federal government would be precluded from bestowing a tax benefit on federal retirees that was not also granted to state retirees. But it is worth noting simply that "the two cases are not

These concerns, however, are alleviated when the state tax is nondiscriminatory. For when a State taxes those who deal with its own institutions to the same extent as those who deal with federal institutions, the State cannot harm the federal government without inflicting an equal harm upon its own operations. Thus, although "the political check against abuse of the power to tax a State's constituents is absent when the State taxes only a federal function" (*United States* v. *County of Fresno*, 429 U.S. at 458), "[a]s long as the tax imposed on those who deal with the Federal Government is an integral part of a tax system that applies to the entire State, there is little chance that the State will take advantage of the Federal Government by increasing the tax." *Washington* v. *United States*, 460 U.S. at 546.[10]

One might argue that the tax in question here, since it applies to retirees of private employers as well as to federal retirees, "affect[s] enough voters in the State to provide the type of political safeguard envisioned in *M'Culloch* and thereby protect federal employees from the risk of disparate treatment." *County of Fresno*, 429 U.S. at 468 (Stevens, J., dissenting). But this Court's decisions do not

on the same reason." *McCulloch* v. *Maryland*, 17 U.S.C. (4 Wheat.) at 435-436.

[10] The Senate Report that accompanied the predecessor of 4 U.S.C. 111 made clear that, for precisely this reason, any tax a State imposes on federal employees must also be imposed on state employes. S. Rep. 112, 76th Cong., 1st Sess. 9 (1939):

> It should be kept in mind that the proposal before us provides only for nondiscriminatory taxation of the compensation of public employees and is reciprocal in nature. Thus, whatever burden might be passed on to one government because of the taxation of its employees' compensation by another governmental unit would, in a measure at least, be offset by the converse application of the proposal.

suggest that a case-by-case inquiry into "virtual representation" is required once it has been shown that a State is treating those with whom it deals more favorably than those who deal with the federal government. Such an approach would in all likelihood prove to be judicially unmanageable, and would only foster "inconsistent decisions and excessively delicate distinctions" (*United States* v. *New Mexico*, 455 U.S. at 730). Instead, once it has been shown that a State's system of taxation, viewed as a whole, treats the State or those with whom it deals more favorably than the federal government and those with whom it deals, this Court's decisions indicate that discrimination will be presumed. See, *e.g.*, *Memphis Bank & Trust Co.* v. *Garner*, *supra; Moses Lake Homes, Inc.* v. *Grant County*, *supra; Phillips Chemical Co.* v. *Dumas Independent School Distr.*, *supra*. Such a rule is not only administratively convenient, it also serves to protect the important policy concerns underlying the doctrine of intergovernmental tax immunity. See *Washington* v. *United States*, 460 U.S. at 546 ("As long as the tax imposed on those who deal with the Federal Government is an integral part of a tax system that applies to the entire State, there is little chance that the State will take advantage of the Federal Government by increasing the tax."); *South Carolina* v. *Baker*, slip op. 19 n. 13 ("the best safeguard against excessive taxation (and the most judicially manageable) is the requirement that the government tax in a nondiscriminatory fashion").[11]

[11] In any event, even if a case-by-case examination of whether the federal government's interests would be adequately represented in the state political process were thought to be appropriate, it is far from clear that private employers operating in Michigan would effectively

Thus, only if the State treats those who deal with the federal government in the same way that it treats those who deal with the State and its political subdivisions can the proper balance of interests sought by the doctrine of intergovernmental immunity be assured. Simply put, the State must make a choice: it can impose a tax on both federal and state pensions (thereby increasing the costs of both the federal and state governments) or it can make both federal and state pensions nontaxable (thereby decreasing the revenues of both federal and state governments). But it cannot impose a tax on federal pensions that does not apply to state pensions, a tax that increases the costs and decreases the revenues of the federal government

represent the interests of the United States. First, private employers, unlike the United States, are subject to corporate and other taxes in the State. Revenues that the State obtains by taxing the pensions of all non-state employees may be reflected in lower corporation or other taxes. Thus, the overall tax structure may well induce private employers operating in the State to favor higher taxes on pensions—where the costs are shared by the federal government—to higher taxes elsewhere that are not shared by the federal government. Second, the United States itself imposes a tax on pensions—both state and federal. See 26 U.S.C. 61(a)(11), 457. Thus, the United States, in addition to paying higher pensions to counterbalance the state tax, will enjoy lower revenues because state pensions, reflecting the fact that they are not taxed by the State, will be lower. See p.14 and n.8, *supra*. Since private employers obviously do not tax state pensions, their interests on this question will again diverge from those of the United States, making effective representation of the interests of the United States doubtful. Obviously, the question whether private employers would provide effective representation of the interests of the federal government here cannot be calibrated with precision; but this simply underscores the wisdom of *presuming* discrimination whenever the State treats those with whom it deals more favorably than those who deal with the federal government.

while simultaneously decreasing the costs and increasing the revenues of the state government. The doctrine of intergovernmental tax immunity was designed to prevent precisely this sort of parochially-motivated disparity in treatment; "it does not seem too much to require that the State treat those who deal with the Government as well as it treats those with whom it deals itself." *Phillips Chemical Co.*, 361 U.S. at 385.[12]

"Although the scope of the Federal Government's constitutional tax immunity has been interpreted more narrowly in recent years, there has been no departure from the principle that state taxes are constitutionally invalid if they discriminate against the Government." *Memphis Bank*, 459 U.S. at 397 n.7. In this "much litigated and often confused field" (*United States* v. *City of Detroit*, 355 U.S. at 473), we know of no case in which the Court has countenanced "so substantial and transparent a discrimination" (*Phillips Chemical Co.*, 361 U.S. at 387) in favor of those who deal with the State and against those who deal with the federal government. "[I]t still remains true,

[12] For purposes of future taxation, the State could respond in a number of ways to a judgment invalidating the differential treatment of former state and federal employees, including eliminating the special exemption for former employees of the State and its political subdivisions, as well as extending this exemption to former federal employees. As in cases claiming a denial of equal protection, the appropriate *prospective* remedy here "is a *mandate* of equal treatment, a result that can be accomplished by withdrawal of benefits from the favored class as well as by extension of benefits to the excluded class." *Heckler* v. *Mathews*, 465 U.S. 728, 740 (1984) (emphasis in original). With respect to past taxes, however, the State's only option appears to be to give appellant a refund of any taxes he has paid on his federal pension. This Court has twice stated simply that "a discriminatory tax is void and 'may not be exacted.'" *Moses Lake Homes* v. *Grant County*, 365 U.S. at 752 (quoting *Phillips Chemical Co.*, 361 U.S. at 387).

as it has from the time of *M'Culloch* v. *Maryland,* 4 Wheat. 316, that a state tax may not discriminate against the Government or those with whom it deals." *Phillips Chemical Co.,* 361 U.S. at 387.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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